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In the Supreme Court of the United States

E. Joseph Face, Jr., Commissioner of Financial Institutions, Bureau of Financial Institutions, Virginia State Corporation Commission, ET AL.,
Petitioners,

v.

National Home Equity Mortgage Association,
Respondent.

On Petition For Writ of Certiorari
To The United States Court of Appeals
For The Fourth Circuit

BRIEF OF THE OFFICE OF THE KANSAS STATE BANK COMMISSIONER, AS *AMICI CURIAE* IN SUPPORT OF PETITIONERS

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INTEREST OF THE AMICI CURIAE

This case addresses the appropriate scope concerning the preemption of state consumer protection laws by federal statutes and agency rules regarding mortgage financing. Specifically, the preemption of state prepayment penalty restrictions or prohibitions concerning alternative mortgage transactions made in accordance with Title VIII of the Garn-St. Germain Act of 1980. A state's ability to enact and enforce borrower protection measures is of great significance and any federal statute or rule that interferes with that ability should be narrowly tailored to achieve its desired effect. The State of Kansas, as well as any state that has laws limiting or prohibiting prepayment penalties, will be affected by the Court's decision. Other states and officials have expressed their intent to participate in this action as *Amici Curiae* and will be identified in subsequent filings with the Court. Consent to file this brief was granted by all parties, in accordance with Supreme Court Rule 37(2)(a).[1]

SUMMARY OF ARGUMENT

The Office of the Kansas State Bank Commissioner is in complete agreement with the position advanced by the Petitioners. In the early 1980's, Congress enacted a number of laws designed to alleviate volatile and increasingly high market interest rates and the resulting inability of lenders to make home mortgage loans at fixed interest rates. Consistently, such legislation involved measures to increase the availability of alternative mortgage transactions ("AMTs") for both State and Federal lenders. Prepayment penalties are not, however, an inherent part of AMT and

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[1] No counsel for a party to this action authored this brief, in whole or in part, and no other person or entity made a monetary contribution to the preparation or submission of this brief.

there exists no indication that Congress intended to preempt state laws limiting or prohibiting the same.

ARGUMENT

FEDERAL LEGISLATIVE MATERIALS CONCERNING THE PASSAGE OF THE ALTERNATIVE MORTGAGE TRANSACTION PARITY ACT ("AMTPA") ARE COMPLETELY VOID OF ANY INDICATION THAT CONGRESS INTENDED THE PREEMPTION OF STATE LAWS LIMITING OR PROHIBITING PREPAYMENT PENALITES.

As stated by the Petitioners, the legislative history of AMTPA is "sparse." (Pet. App. At 20) Although Petitioners' brief adequately identifies and addresses a majority of the legislative history concerning the passage of AMTPA, there exists some additional information that may be helpful to the Court.

On April 7, 1981, the Senate held the first of many hearings concerning the great distress plaguing the home finance industry caused, primarily, by a period of overwhelming inflation.[2] Senator Jake Garn was the Chairman of the Committee on Banking, Housing, and Urban Affairs at the time, and was present at the Hearing. Jerry Pohlman, the Vice President and Chief Economist for California Federal Savings & Loan made the following statement at the Hearing:

> [T]he development of new mortgage instruments is fundamental for successful adjustment to our current economic

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[2] *Federal Role in Conventional Home Financing: Hearing Before the Subcommittee on Housing and Urban Affairs of the Committee on Banking, Housing and Urban Affairs*, 97th Cong., 1st Sess. 13 (1981).

> environment. The problem we face today is rooted in the persistent and seemingly intractable inflation we have witnessed in recent years. . . . Thrifts' extensive use in the past of the long-term, fixed-rate conventional mortgage is the prime reason why the bulk of associations are experiencing operating losses. Like other financial intermediaries, S. & L.'s income depends upon the difference between what they pay on savings and other investments and the interest they receive on loans. . . . It is ignoring reality to believe that thrifts can pay rapidly changing market rates on deposits to keep savers abreast of inflation without having mortgage interest rates vary as well. In order for thrifts to survive . . . they will have to offer mortgages which have yields that vary with the market. In times like these, following the traditional path of borrowing short and lending long will only push thrifts down a road which leads to insolvency and result in an even more devastating impact on funds available for housing.[3]

Cantwell F. Muckenfuss III, Senior Deputy Comptroller for Policy, Comptoller of the Currency, made the following Statement during the Hearing:

> First of all, inflation and resulting high and volatile interest rates have had devastating effects on housing and housing finance in recent months. Those financial institutions

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[3] *Id.* at 33 & 44.

> whose portfolios are composed primarily of long-term fixed-rate mortgages have suffered a precipitous drop in earnings as their cost of funds have risen well above the average return on their portfolios. . . . The 30 year fixed-rate mortgage is a venerated element of our system of housing finance and it has served the Nation well. The move to a world of greater flexibility was revolutionary. Our office did not take action to facilitate this change lightly.
>
> Yet we firmly believe that changed circumstances demanded this step. Other steps, equally dramatic, may be required if we are to fight inflation and at the same time continue our commitment to a "decent home and suitable living environment" for every American.[4]

Also included within the Hearing record, which exceeds 200 pages, are statements made by Robert McKinney, Chairman, First Federal Savings & Loan Association; John Dalton, Chairman, Federal Home Loan Bank Board; Emanual Savas, Assistant Secretary for Policy Development and Research, Department of Housing and Urban Development; David Kresge, Director, Harvard-MIT Joint Center for Urban Studies; William Silber, Professor, Graduate School of Business, N.Y.U.; and Kent Colton, Professor, Graduate School of Management, B.Y.U. The overriding concern of each of the Committee, and each expert witness that presented testimony at the Hearing, was combating inflation, and providing funds for homebuyers, by ensuring that financial institutions had the ability to offer adjustable rate mortgages. Prepayment penalties were never mentioned by the Committee, or any expert witness, and there is no

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[4] *Id.* at 80 & 84.

indication that either considered prepayment penalties as an inherent aspect of, or an impediment to, AMTs.

On December 10, 1981, the House of Representatives held a similar hearing concerning the persistent and seemingly intractable inflation, which was affecting the home finance industry.[5] Representative Fernand J. St. Germain, Chairman, asked his Committee the following question, "Should Federal law provide a preemption of state usury ceilings – on consumer loans and in modified form on business and agricultural loans – with states having a time period within which to reimpose state ceilings, or should a national usury law be enacted?" In response, Representative Bill McCollum made the following statement:

> The Chairman's opening statement raises an issue that I think, Mr. Pierce and Mr. Phillips, is important to all members. That is with regard to housing and maintenance of an adequate level of housing. I would like to ask each of you, how can we assure proper flow of funds to housing in a deregulated banking environment? . . . What is to assure us in the future, if the thrift institutions become more like banks, and banks become more like everybody else and the playing field is leveled, that we are going to have bankers or the new level playing field, or whatever nature they are, to put money in housing and make those kinds of commitments which apparently commercial interests today don't find as nice or as profitable?

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[5] *Financial institutions in a revolutionary era: Hearing Before the Committee on Banking, Finance and Urban Affairs, House of Representatives*, 97th Cong., 1st Sess. 72 (1981)

Obviously, the overriding concern of the Committee was ensuring an adequate level of available financing for the purchase of homes by this Nation's citizens, through the use of adjustable rate mortgages. Again, the Hearing record is completely void of any reference to prepayment penalties. Such omission is a clear indication that Congress did not associate prepayment penalties as an inherent or integral part of AMTs, nor did they view state law limitations on prepayment penalties as one of the problems.

LEGISLATION ENACTED BY CONGRESS PRIOR TO AMTPA, WHICH WAS DESIGNED TO ALLEVIATE THE INFLATIONARY PROBLEMS PLAGUING THE MORTGAGE INDUSTRY, SUPPORT PETITIONER'S ARGUMENT.

In 1980, two years prior to the enactment of AMTPA, Congress enacted the Depository Institutions Deregulation and Monetary Control Act ("DIDMCA"). Under Title V of DIDMCA, federal lenders were provided an exemption to state interest rate limits on "federally related mortgage loans" as defined in 12 U.S.C. § 1735f-5(b). "Federally related mortgage loans," are defined by 12 U.S.C. 1735f-5(b) as:

[A]ny loan which--

> **(1)** is secured by residential real property designed principally for the occupancy of from one to four families; and
>
> **(2)(A)** is made in whole or in part by any lender the deposits or accounts of which are insured by any agency of the Federal Government, or is made in whole or in part by any lender which is itself regulated by any agency of the Federal Government; or

> **(B)** is made in whole or in part, or insured, guaranteed, supplemented, or assisted in any way, by the Secretary of Housing and Urban Development or any other officer or agency of the Federal Government or under or in connection with a housing or urban development program administered by the Secretary of Housing and Urban Development or a housing or related program administered by any other such officer or agency; or
>
> **(C)** is eligible for purchase by the Federal National Mortgage Association, the Government National Mortgage Association, or the Federal Home Loan Mortgage Corporation, or from any financial institution from which it could be purchased by the Federal Home Loan Mortgage Corporation; or
>
> **(D)** is made in whole or in part by any "creditor", as defined in section 1602(f) of Title 15, who makes or invests in residential real estate loans aggregating more than $1,000,000 ~~per year~~.

AMTs are, therefore, "federally related mortgage loans." When enacting DIDMCA, however, Congress specifically stated that "other charges" shall not be construed to mean prepayment charges, attorneys' fees, late charges, or other borrower protection provisions applicable to home mortgage loans.[6] Specifically, 12 C.F.R. § 590.3 states, . . . (c) Nothing in this section preempts limitation in state laws on

[6] S. Rep. No. 368, 96 Cong. 2d Sess. 19 reprinted in 1980 U.S.C.C.A.N. 236, 255.

prepayment charges, attorneys' fees, late charges or other provisions designed to protect consumers. Additionally, regulations by the Office of the Thrift Supervision ("OTS"), promulgated under DIDMCA, contain the same language (See, 12 C.F.R. § 590.3(c)). Therefore, DIDMCA, which by definition would include an "alternative mortgage transaction," would have to be read in contravention of AMTPA, as well as the rule of statutory construction applicable to laws in pari material, given the decisions adopted by the courts below. Finally, it is important to note that an AMT does not need to contain a prepayment penalty to qualify as an AMT.[7]

CONCRESS DID NOT INTEND TO GIVE FEDERAL AGENCIES THE AUTHORITY TO EXPAND THE SCOPE OF AMTPA'S STATE LAW PREEMPTION THOUGH REGULATIONS THAT AUTHORIZE CONTRACTUAL PREPAYMENT PENALTIES IN CONTRAVENTION OF STATE LAWS.

In AMTPA, Congress provided that state chartered housing creditors may **make, purchase, and enforce** AMTs if they comply with regulations issued by the appropriate federal agency, to the extent that such regulations are authorized by rulemaking authority. In Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837, 842-43, 104

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[7] 12 U.S.C. § 3802(1) defines an "alternative mortgage transaction as: a loan or credit sale secured by an interest in residential real property. . . (A) in which the interest rate or finance charge may be adjusted or renegotiated; (B) involving a fixed-rate, but which implicitly permits rate adjustments by having the debt mature at the end of an interval shorter than the term of the amortization schedule; or (C) involving any similar type of rate, method of determining return, term, repayment, or other variation not common to traditional fixed-rate, fixed-term transactions, including without limitation, transactions that involve the sharing of equity or appreciation; described and defined by applicable regulations; . . .

S.Ct. 2778, 81 L.Ed.2d 694 (1984), the Supreme Court addressed the proper deference that should be given to a federal agency's interpretation of a statute. In doing so the Court held, "[If] the plain language of the statute addresses the precise issue . . . . that is the end of the matter because courts as well as agencies must give effect to the unambiguously expressed intent of Congress." Clearly, AMTPA provides authority to the Federal agencies to promulgate regulations that are necessary to allow state-chartered banks and housing creditors to "make, purchase, and enforce" AMTs. Any federal regulation that exceeds this purview should not be included within the preemptive implication of AMTPA.

Upon passage, AMTPA directed the appropriate federal agencies to "identify, describe and publish (and conform as necessary) their AMT-enabling regulations. In response, the FHLBB published three "Notice(s) to Housing Creditors."[8] In those three publishings, the FHLBB clearly omitted any reference to regulations concerning prepayment penalties. In fact, FHLBB stated the following during its May 23, 1983 rulemaking:

> The Board's approach to the applicability of its regulations is premised on the clear statement of Congressional intent that Title VIII "does not place non-federally chartered housing creditors under the supervision of the federal agencies, but instead merely enables them to follow a federal program as an alternative to state law.' S. Rep. No. 97-463, 97th Cong., 2d Sess. 55. The Notice to Housing Creditors should, therefore, identify as appropriate those regulations that further "describe and define" (section 803(1)) alternative mortgage transactions, and not

[8] See, 47 F.R. 51733, 48 F.R. 23076, and 49 F.R. 43043.

> those regulations intended for the general supervision of Federal Associations.

In that same document, the FHLBB went on to identify and list the regulations that it deemed appropriate for carrying out the intent of AMTPA. Regulations authorizing the use of prepayment penalties were not included. Finally, although AMTPA does provide that subsequent changes in federal regulations are authorized to carry out the intent of the Act, it does not mean that federal agencies are free to expand the scope of AMTPA to include areas outside the original intent of Congress and, thereby, preempt more state laws. Federal agencies have confused their limited role granted by Congress under § 807(b) of AMTPA by expanding its scope to include application of federal regulations concerning prepayment penalties.

As this Court has held, Congress's intent to preempt must be "clear and manifest: to preempt state law in a field traditionally occupied by the states, such as the exercise of a state's police powers.[9] Additionally, a state's police powers extend to issues of consumer protection, such as the limitation or prohibition of prepayment penalties, and a presumption against preemption should apply to the present action.[10]

Clearly, those federal agencies that have extended the preemptive effect of AMTPA to include prepayment penalties have done so without authority granted by Congress and in degradation of a state's right to protect its citizens.

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[9] Medtronic, Inc. v. Lohr, 518 U.S. 470, 485, 116 S.Ct. 2240, 135 L.Ed.2d 700 (1996).

[10] California v. ARC America Corp., 490 U.S. 93, 109 S.Ct. 1661, 104 L.Ed.2d 86 (1989).

CONCLUSION

For the foregoing reasons, the Office of the Kansas State Bank Commissioner respectfully urges the Court to reverse the lower court decision.

Respectfully submitted,

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